RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 29, 1983 **LETTER 864**

June 17, DJIA 1242.19; PTI 1661; A-D Ratio –12.42
June 24, DJIA 1241.69; PTI 1669; A-D Ratio –12.53

THE MARKET: The biggest cliché in this business has become the number of bulls and bears among the advisory services. Almost every investment service I read now points to the "fact" that "only 11.1% of the advisories are now bearish." The conclusion is that a major correction is upon us. Maybe so, maybe it's time. But I'm reminded of a stock market adage that has withstood the test of time—"What everyone knows ceases to be a factor on Wall Street." And EVERYONE knows that there are too few bears around today (they've known that for the past four months).

As shown in the last Letter, my PTI has been holding steadily above its rising trendline—and hitting high after high after high. On June 15 the market confirmed with a rather rare and bullish event. The event was a SIMULTANEOUS UPSIDE PENETRATION by both the D-J Industrial and Transportation Averages. As a rule, this is one of the strongest bull signals that can be given by the stock market (i.e., new primary highs *on the same day* by the Industrials and Transports).

As for confirmation by other indices, there were plenty. On the same day the S & P 500 hit a new high as did the NYSE Composite, the D-J 65 Average and the A-D ratio (for the NYSE) as well as the PTI. There were no real divergences or discrepancies on the upside breakout. It was the bull's way of saying, "I'm still in charge. I still own the stock market. The trend is up."

The market of late (towards the end of June) has been a bit ragged, but as late as June 22 the PTI recorded a new record high of 1669. The advances by the market so far continued to be more impressive than the declines. See late notes for more on this.

But today's investors are very sophisticated. "The bull market can't continue," we say. "There's too much debt, there's too much unemployment. And interest rates are too high, and the arms build-up will abort it." We know with certainty what the market can and can't do, and in our stubborn arrogance we often place our bets against the trend (as the short sellers have been doing for many months).

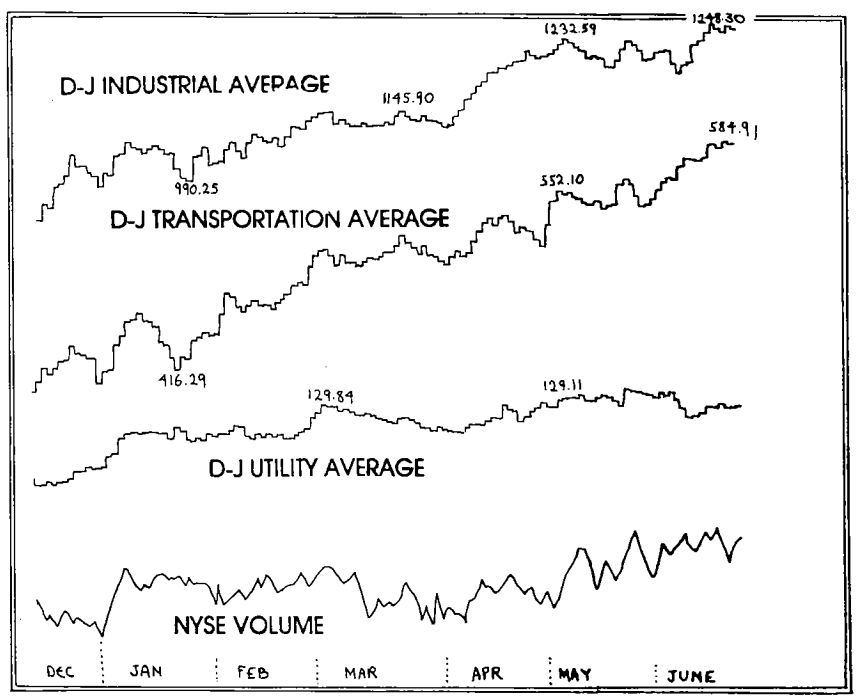
And I think back to William P. Hamilton, the great editor of the Wall Street Journal during the 1920s. Hamilton was a pioneer Dow Theorist, and no one had more faith in the market's predictive value than Hamilton. Hamilton was forever trying to teach his readers to respect what he termed the "bloodless verdict of the marketplace."

Here, I'll give you a piece of Hamilton's wisdom, this was written in 1922 and pertaining to the stock market and farming: "The farmers say . . . .'What does Wall Street know about farming?' Wall Street knows more than all the farmers put together ever knew, what all the farmers have forgotten. It can, moreover, refresh its memory instantly at any moment. It employs the ablest of the farmers, and its experts are better than even those of our admirable, and little appreciated Department of Agriculture, whose publications Wall Street reads even if the farmer neglects them."

Which brings me to the present. And we think to ourselves, "What does Wall Street know about the horrendous problems of today? What does Wall Street know of $6 trillion in US debt, and Lord knows how many billions in foreign debt, and US factory usage and low productivity and over-priced US cars and an over-competitive US computer industry?" And my answer (straight from Hamilton) is that Wall Street has taken in ALL

THE PICTURE: The great Russian writer, Dostoievski wrote, "Be simple and rediscover the world." In fact, one of Dostoievski's great characters in his novel, "The Idiot" was simple to the point of appearing almost retarded. The idiot saw through sophistication and deceit with such searing truthfulness that he turned out to be more saint than idiot.

But being simple, seeing things in their essence, is anything but easy. For instance, the basic concept of Dow's Theory is that the market moves in broad, extended TRENDS. A rising trend, lasting a few years or more, is termed a bull market. A bull market once started, will continue to conclusion. It can be interrupted, it can be temporarily held back, but a bull market is comparable to the tide of the ocean. It will play out its drama to conclusion, and no man or group of men can hold it or keep it from ultimately expressing itself.

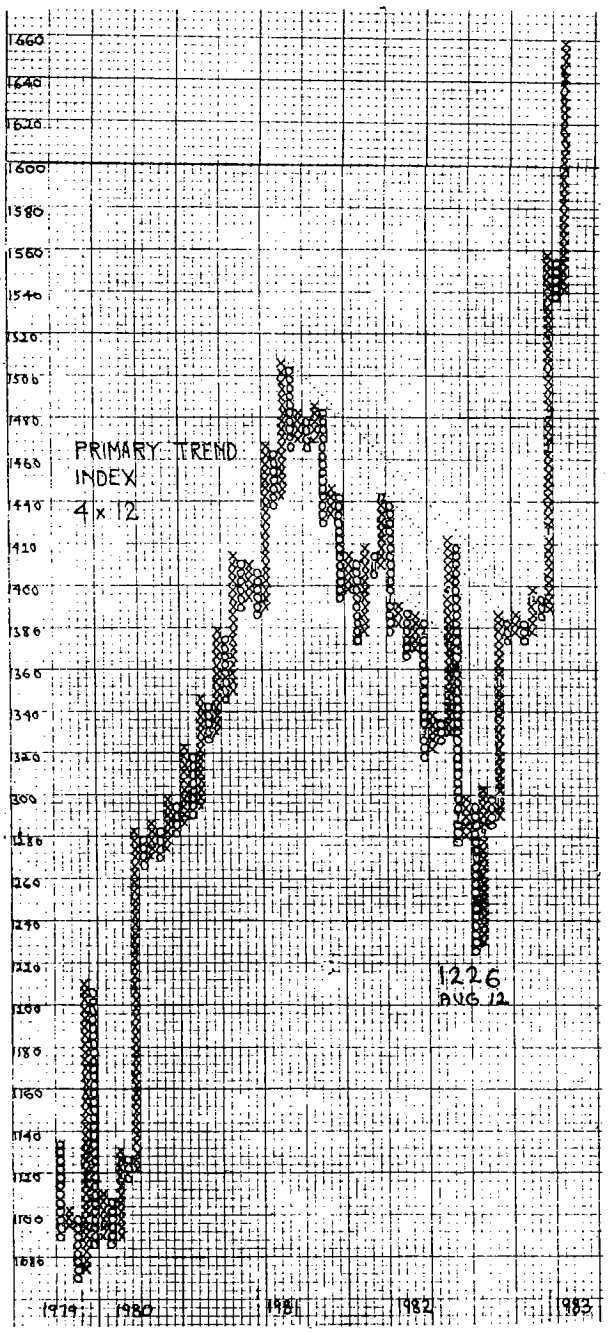


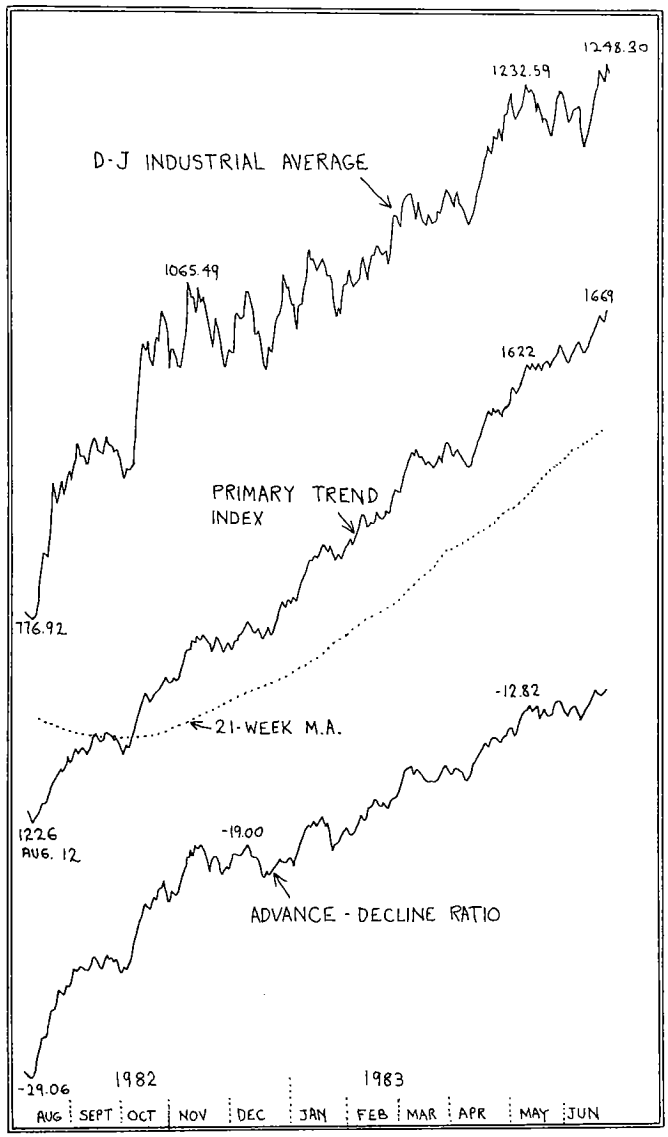
the facts. The stock market knows more than the President, the President's Economic Council, plus all the economists in the nation taken together.

Today Wall Street is telling us that a primary bull market is in force, and you can (1) believe it and act on it, or (2) you can disbelieve it, and ignore it, or (3) you can deride the market and bet against it, putting out shorts or loading up on put options.

But I submit that the winners will be those (and they have been up to now) who believe the market and have acted on it. In an effort to be "simple", I long ago constructed a line which I call my Primary Trend Index (PTI).

To understand the PTI you must be able to recognize up from down. The PTI (as noted in these reports) has been moving up for ten months and is still moving up. It has been providing the





profile for a bull market, and I guess that's simple enough. My defense stock list and its performance amply illustrates what you can do in a bull market. But in the final analysis, each man has to kill his own snakes, and you either believe what the stock market is telling you–or you just don't (and that's an area where, unfortunately, I can't help you).

PTI: For the benefit of new subscribers, I want to comment further on my Primary Trend Index. The PTI is an amalgum of eight technical indices and averages. The PTI measures the technical undertone of the market. As I've said so many times, it's literally impossible for the PTI to hold to a sustained uptrend without dragging the market up with it. And it's equally impossible, when the PTI enters a persistent downtrend, for the market to withstand the negative pressure.

This point and figure chart of the PTI shows what I consider an astounding picture. Never, in the 13 years that I have been charting the PTI, have I seen anything like the current "power-rise." During most of the rise (and certainly at present) leading analysts and commentators have been warning of "a severe market correction, if not a collapse." But it hasn't happened. In fact, the most that has occurred is a series of minor consolidations, and these can be seen on the PTI chart.

Can this kind of powerful action continue without a major correction? Well, every bull market has its own brand of de-

ceptiveness, and every bull market has its foolers. Neither I nor anyone else knows how long this relentlessly bullish action will last. But one thing is clear. All consolidations ("congestion areas") since August 1982–have (so far) been resolved to the upside.

INVESTMENT POSITION: Nothing has changed. We sit with our no-load mutual funds and our position in the defense stocks. The bull is still king of this box, and what more needs to be said?

PERSPECTIVE: I seem to have an obsession with long-term charts these days. But here's a chart that I've kept up for years. What's so fascinating to me is the long period of consolidation in the Dow, a period that ran from roughly 1964 to 1983. Then we see the breakout in 1983, taking the Dow well into the 1200-and-above area.

A pullback would not be unexpected at this time, but there is no denying the significance of the breakout. Before this bull market is over, it could well be that the Dow will connect with the upper trendline. As you can see on the chart, such a move would take the Dow far above 2000.

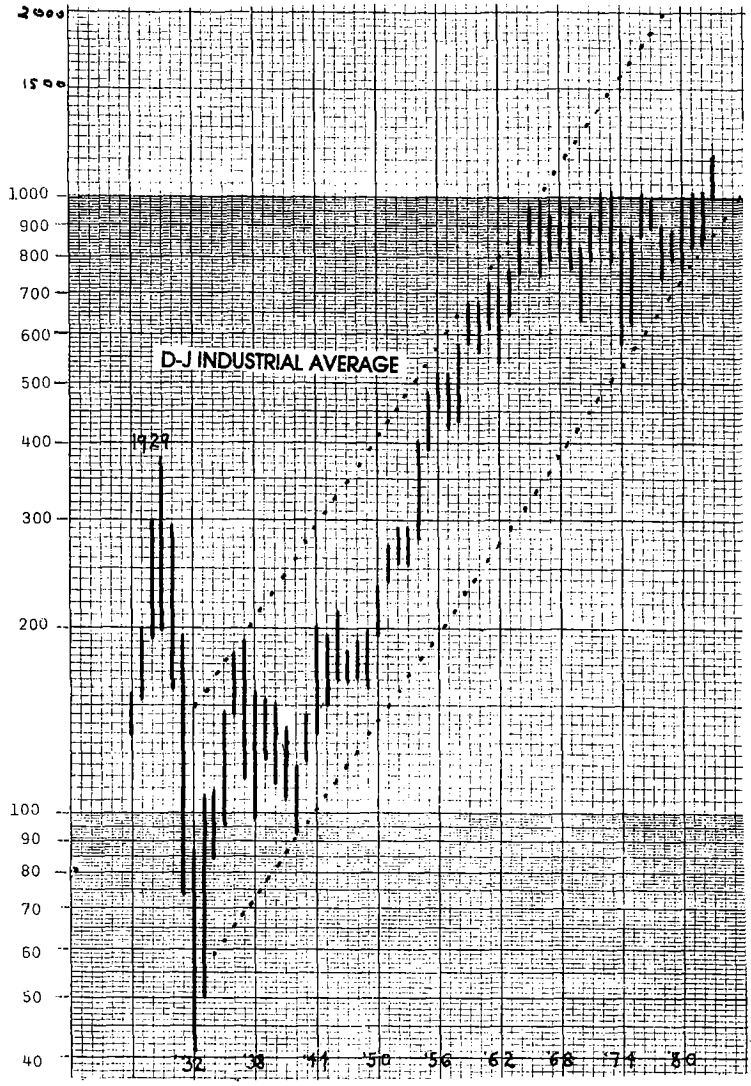
A second perspective on the current bull market is this chart of the D-J Industrials and the *much broader* Value Line Industrial Average. The Value Line Average includes the action of 1500 stocks.

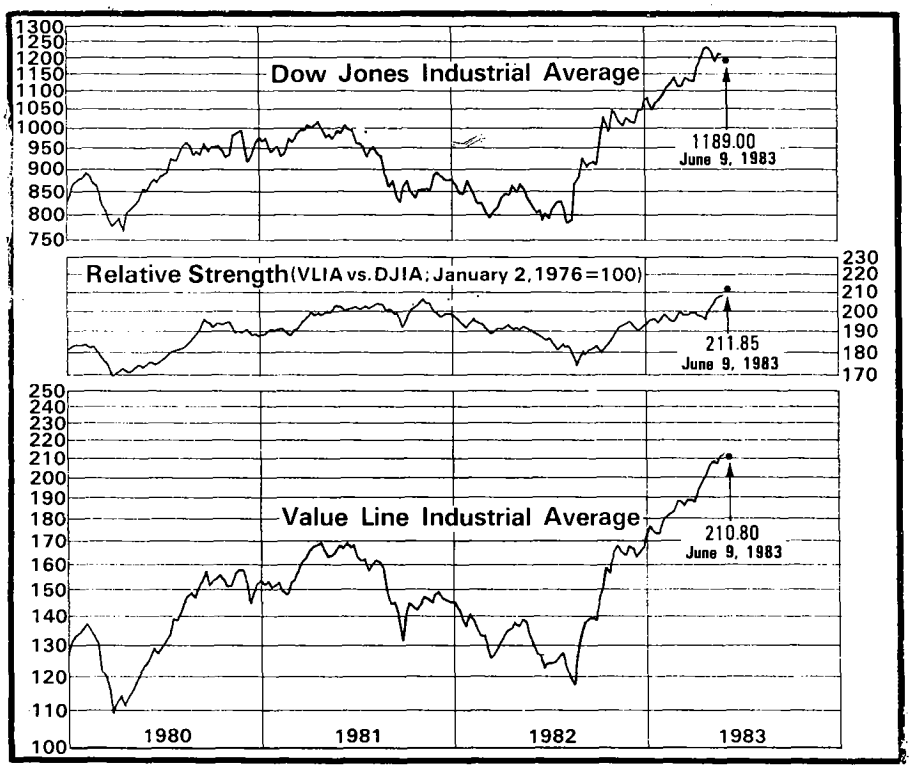
The salient point of this study is the relative strength action of Value Line vs. the Dow. Note that Value Line RS has been rising ever since the August, 1982 bottom. This is telling us that there has been broad and persistent participation in this market by the *majority* of the 1500 Value Line stocks. Since the Value Line is such a broad index, it is almost a proxy for market breadth, and market breadth has been extremely impressive during the bull market so far.

In weaker markets it is usual to see the Dow acting powerfully while the remainder of the market lags. In such instances, the widely publicized Dow acts as a cover-up while the run of the mill stocks are distributed. But today's powerful bull market is literally across the board. Massive amounts of money have gone into this bull market, and there has been no let-up. To put it mildly, it's a bull market of historic breadth and scope.

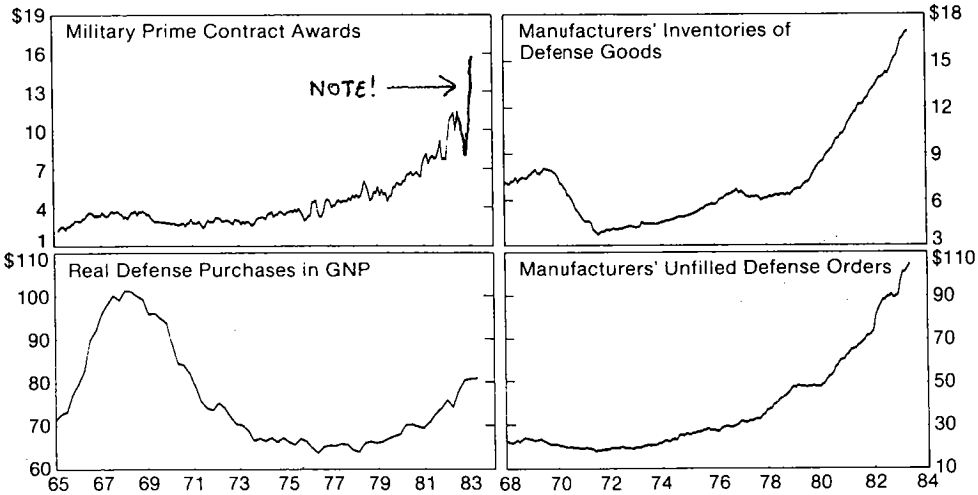
DEFENSE: With our defense list of stocks up well over 40% since February 25, I don't feel I have to justify buying these issues. But I feel that the background for purchase of these stocks is both interesting and important to us as Americans and as investors.

Since the last Letter, two items in the military area have caught my eye. The first is the chart page from Salomon Brothers' "Comments on





Selected Defense Indicators
(Monthly Data, Except for Quarterly GNP; Dollars in Billions)



Credit" publication (see my page 4). States Dr. Henry Kaufman, "One of the earliest signs of defense-related activity is military prime contract awards, which have risen at a rate of 20% in the first half of fiscal 1983, only a modest slowing from the heated 25% surges in each of the two previous fiscal years (see top left panel of accompanying charts). This strength has contributed to an 11% jump in the production of defense and space equipment over the past 12 months, which, in turn, is causing an escalation in defense inventories."

At any rate, I think these four charts will provide readers with some idea of the massive defense build-up which is now on the way. The prime contractors usually receive the initial contracts, but the sub-contractor (which all my listed defense stocks are) will get theirs as the work filters down.

The second item of interest was the *Business Week* cover story of June 20, 1983. The article is entitled, "The US Returns to Space." I include the opening paragraph from the BW story below.

> The U. S. is returning to space. For the first time since the dramatic Apollo landings on the moon, the nation's research and technology establishments are being asked to make an all-out effort to reestablish America's space supremacy. The future will see permanent research laboratories—and eventually even factories—orbiting above the earth. But ominously, space also is in danger of becoming an arena for war.

The fact is, states the article (which quotes an Air Force space expert) that "The President has recognized that we are entering a new era in space. His goal is to establish US leadership in space, an he is simply encouraging us to advance there as fast as we can." The article then goes on to say that the coming battle will be for control of outer space. This will carry "an enormous price tag" but it must be done. The international battle for outer space is now on in full force.

> **TO CLOSE A GAP.** What triggered the President's call for space defense is the Soviet Union's chilling progress in establishing a military presence in space and in neutralizing U. S. land-based missiles. The Soviets have clearly opened a gap in manned space flight (page 66), and some defense analysts believe they are also ahead of the U. S. in developing lasers and other "death-ray" weapons capable of destroying satellites and intercontinental ballistic missiles (ICBMs).
>
> Now the Soviets are building their own reusable space shuttle. They already have a small, shuttlelike craft that looks as though it were designed to operate as a space fighter (picture, page 60)—a "plane" that the U. S. Air Force has only on paper. The Kremlin's advances "make me very concerned about the Soviet threat in space," remarks Major General John H. Storrie, commander of the Air Force's nine-month-old Space Directorate.

I talked to Melvyn Lippman last week about the BW article and about the situation in general. He said, "It's much more ominous than people think. Do you remember how we used to feel about the Russians twenty and even ten years ago? They were primitive, bumbling, behind the times. Now they are surging ahead in all areas of science and the military. And here's the ominous part of it—they have a purpose, a definite purpose. And we won't know about that purpose until THEY ARE READY TO SHOW THEIR HAND." That's it . . . . if you can fully comprehend the meaning of Lippman's words, then you know there is going to be big trouble ahead—somewhere ahead, and at the discretion of the Russians. It will happen *when the Russians are thoroughly ready to confront us,* and that means when they feel they have undeniable superiority in the military!

Defense Analysis: The June 15 WSJ contained an article on Scientific-Atlanta. The article discussed the success of SFA's cable converters, which are being shipped at the rate of 30 to 50 thousand a month. But little was said about the area I am interested in—defense. And defense should prove to be the big kicker in SFA's future.

Financial World this month included a piece on BDM International, another of "our stocks." I include a section below, and here some of the defense aspects are at least suggested.

> At 33 times trailing earnings of $1.11 and 28 times 1983's estimates, BDM sports a lofty multiple. What are the reasons? An important one is that BDM is positioned in almost all of today's "hot" areas: technical and professional services for the Department of Defense; high-powered laser research; and specialized computer software. More important, Wall Street seems finally to have taken full note of this classically managed service outfit, which has been compounding its earnings at a 33% annual clip for the last 10 years. Better yet, the $118 million company has averaged 24.4% on its shareholders' equity during that time—all

without borrowing a penny of long-term debt.

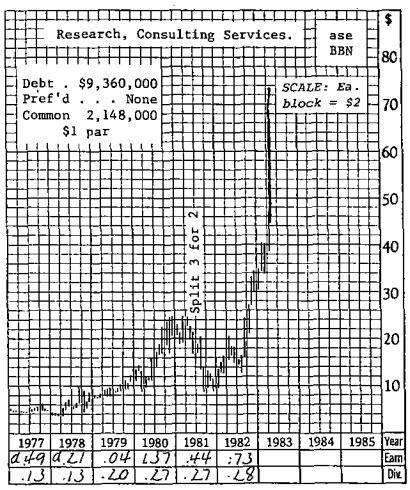
BDM's earnings for 1982 rose 42% to $1.03 (adjusted for the split), while this year's first-quarter earnings rose 38% to 29¢. Says president and CEO Earle C. Williams, "This year will continue our historical growth trend, and we are predicting more of the same for 1984."

Williams notes that as of March 31 BDM's backlog had increased 14%, to almost $150 million, since the same period in 1982, while the company's contracts under bid increased a whopping 60% to $207 million.

BBN: The accompanying monthly chart (courtesy of Horsey) shows a star in the defense picture, Bolt, Beraneck Newman. Technically, BBN broke out above its previous high at 26. I recommended the stock at 37, and it has since doubled in price. Note that this is a thin issue with only 2.1 million shares outstanding. Of this, about 500 thousand shares are owned by institutions and by a unit of Schlumberger. So there's a very small floating supply of BBN, which may account for some of the meteoric rise.

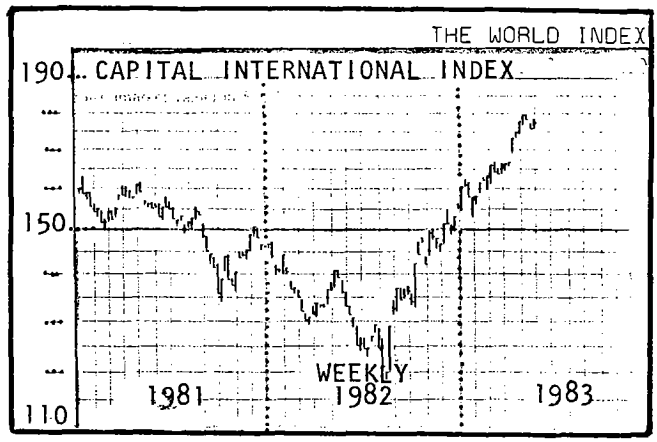
Nevertheless, BBN is fated to be one of the stars in the coming defense boom. Obviously, a number of well-heeled investors are on to the big potential in this stock. BBN is in the midst of a dramatic change from a think tank to a well-rounded company with a product division that will market many new and startling space age products. About 75% of BBN's research and development division involves top-priority work for the US Government. Note: on June 23 BBN announced a 3 for 2 stock split and an 8% increase in payout.

BOLT BERANECK & NEWMAN



NOTICE: I own the recommended defense stocks in a number of different accounts. Due to legal obligations, I will probably liquidate one account completely, and this will entail selling all stocks including the defense stocks in this account. But these stocks are being sold only to satisfy a need for cash. The action is being taken for liquidity needs only–not because I believe the defense shares are a sale. They are a long-term holding.

NOTES & QUOTES: As I've stated before, all primary trends are international in scope. This primary bull market is no exception, as this chart of the Capital International World Index shows. The World Index is made up of a weighted composite of all the major world markets, and on the chart this phenomenal rise very closely resembled the rise in the Dow. So whatever is happening–it's happening all over the Free World.



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DEFENSE STOCKS: One share of each of the 10 original recommendations would have cost $236. One share of each of the three additions would have cost $42–for a grand total of $278. BDM split 2 for 1 and Tracor paid a 25% stock dividend–and I have adjusted for these. Thus, the new and correct figures are shown below, and the four month appreciation in the 13 stocks is an impressive 50%.

		Our Buy Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	44 5/8	Defense stock average based on 1 share of each this week is 418
NYSE	LFE (LFE)	11 7/8	21½	
NYSE	Planning Research (PLN)	14 3/8	21 3/8	
NYSE	Scientific Atlantic (SFA)	19	21 5/8	
NYSE	Tracor (TRR) (25% stock div.)	28 3/4	36	
NYSE	Electronic Assoc. (EA)	13	14 1/8	
NYSE	Varo (VRO)	19	20 1/8	
NYSE	Bolt Beranek (BBN)	37	77½	
NYSE	BDM (BDM) (2 for 1 split)	43½	100	
AMEX	Dynalectron (DYN)	12 3/4	15 3/8	% Increase is: 50%
AMEX	Moog B (MOGB)	15½	23 1/4	
AMEX	Systems Planning (SPZ)	7	12 5/8	
AMEX	American Science (ASE)	10½	10½	
	Original purchase price 278		(revised)	

GOLD: I believe that we are in basically a *deflationary environment.* I believe that if it were not for massive US deficit spending, this nation would now be in the throes of a vicious deflationary collapse. But the huge deficit spending (part civilian, part military) has served to offset the fundamentally deflationary forces. The net result is something that "looks" like stability.

For two years I have been writing that the forces of inflation and deflation were heading for a major confrontation. That con-

frontation is a fact today. But the grim battle is difficult to comprehend. I have used this example: picture two wrestlers locked in a deadly hold. Each is pressing against the other with all his might. They appear motionless, and to the casual observer it might seem that nothing is happening. But obviously, what we see is two forces that are deadlocked–neither one giving an inch. And that's exactly where I believe the forces of inflation and deflation are now.

Ten years ago a deficit of $200 billion would have sent gold flying skyward and it would have sent the bond market into the pits (along with the stock market). Not so today, and the reason is the debt, and more specifically, the deflationary implications of the debt. As I've said so many times, the cost of servicing the total US debt is colossal, and this cost is deflationary. Pit that deflationary situation against today's mind-boggling deficits and you have a stand-off.

The markets sense it. In the face of deficits amounting to almost $4 billion a week, gold is neutral, commodities are only 20% off their 1982-83 lows, farm land is weak, real interest rates are high, and prices of many items (even including housing) are spotty to soft. Cut the deficit spending (which obviously won't happen) and prices would cave in.

In his latest report, Tony Henfrey (Gold Letter, PO Box 5577, Durban 4000, South Africa), a brilliant and emotionless gold expert, states as follows: "Gold made a half-hearted last gasp effort to break above 443, failed miserably and it is already history that it was down to 400 before you could say 'knife'. In the process it has broken below the critical 400 support level and now the long term bull market is being called into question."

I am including this monthly chart from Tony's most recent letter. Here's how I interpret the chart. The line A-C-B is so shallow as to be (in my opinion) almost meaningless. I accept the trendline C-D as the main or primary bullish trendline for gold. This trendline comes in at roughly 330-340 at present. A breaking of line C-D would confirm a bear market in gold.

Descending line G-H is the major bearish trendline for gold. As long as gold is below this line (which it is now) it is reasonable to conclude that the secondary trend is down.

Support line M-N comes in at about 390. A decisive break of this support would indicate a testing of trendline C-D at 340. Thus, from the nearer term standpoint, I am watching two scenarios for gold. (1) Gold rallies above 450-460 and breaks out above trendline G-H. This would be strongly bullish for gold. (2) Gold breaks below support line M-N and moves down to test major trendline C-D. This would be very bearish for gold.

We should see the test somewhere during the next 6 months, perhaps much sooner. I am not paying much attention to the cyclic studies at the bottom of this chart. I think the 5.5 year gold cycle has received too much publicity, and I am now a bit skeptical of the cyclical implications.

I just received the Harry Schultz Letter (PO Box 141, Clarens-Montreux, 1815 Switz.), and I was interested to see that Harry agrees with me on gold. Harry (back from the Blanchard Nassau seminar) said the attendees and speakers were highly bullish on gold. Yes, the trouble with gold is that it gets tied up (more than any item I know) with people's emotions. Hard money people LOVE gold, but loving the gold standard is one thing, and investing in gold is another.

Says Harry, "The big eye openers for me in the Bahamas, amidst all this gold bullishness, was the realization that, just as the world stock markets have been rising for 10 months on a wall of worry, it appears that gold has been sliding on a wall of optimism! The outlook is for more of the same!"

By the way, Schultz's observations jibe with my gold/stock market ratio which shows gold (the ratio) at another multi-year low in relation to common stocks. The chart is telling us that the place to have been and the place to be NOW is in common stocks–not gold.

LATE NOTES: The PTI number for the week ending June 24 was a record 1669! The fact is that PTI readings during down-days have been weak, while PTI readings during rally days have been strong. As long as this action continues, I have to be impressed with this market. Of interest is the fact that market ACTION has been good despite the deterioration in sentiment figures. And as veteran readers of these reports know–I TRUST market action above all else in dealing with the trend.